SLOVAK REPUBLIC

Highlights

- **Gross domestic product (GDP) growth has lost momentum.** Following solid growth stemming from strong household consumption and investment in 2018, the economy has slowed in the first half of 2019, although exports continue to perform well.
- **Measures to simplify foreigners' recruitment have been introduced.** New legislation is intended to shorten the time required for assessing requests from those who live outside the European Union (EU) for residence and employment in the Slovak Republic, particularly in professions with identified labour shortages.
- **Improvements in the fight against corruption have entered into force.** A new independent state administration body provides protection and remuneration to whistleblowers, and monitors the compliance of authorities with the new anti-corruption law.

Key priorities for 2020

- **Educational reform should focus on matching labour demand and supply.** Key short-term measures should include fostering skills, in particular through training and requalification programmes, with a greater engagement of the business sector.
- **Sustainability of the healthcare system needs to improve.** Measures proposed in the Value for Money project in November 2018 would make current healthcare spending more efficient and effective and could free up around €140 million for additional spending in the sector.
- **Decommitment of funds from the EU that have already been allocated should be avoided.** Efforts should be intensified to improve strategic planning, strengthen capacity and overcome administrative problems so that allocated EU funds can be used effectively.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	4.8	2.1	3.0	4.0	2.5
Inflation (average)	-0.3	-0.5	1.4	2.5	2.6
Government balance/GDP	-2.7	-2.5	-1.0	-1.1	-0.9
Current account balance/GDP	-2.1	-2.7	-1.9	-2.6	-2.0
Net FDI/GDP [neg. sign = inflows]	-0.1	-0.8	-2.8	-0.9	-0.1
External debt/GDP	85.2	92.2	107.8	113.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	53.3	57.3	60.4	62.5	n.a.

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Macroeconomic performance

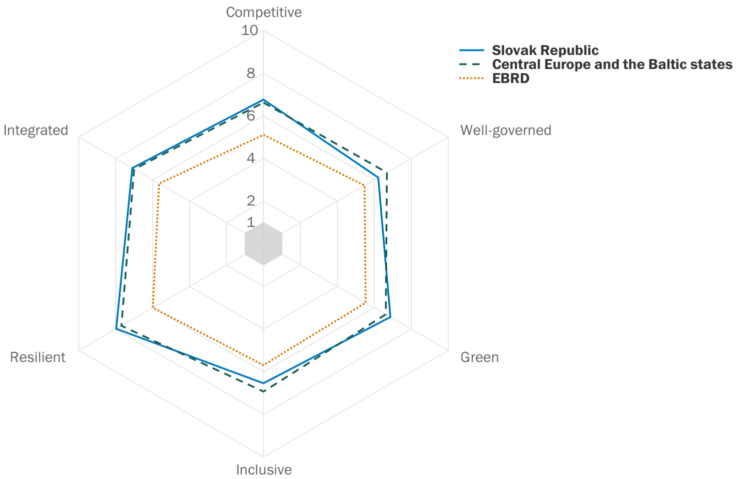
Economic growth has slowed. Domestic demand, particularly household consumption and investment, continued to underpin GDP growth of 4.1 per cent in 2018. However, a slowdown is evident in the first half of 2019, with the economy growing by just 3.0 per cent year-on-year. Despite weakening external demand in western Europe, exports grew by 3.9 per cent in the first half of the year. Inflation accelerated to 2.5 per cent in 2018, and further to 3.0 per cent in July 2019. Service price inflation saw the greatest hikes, in line with expectations of rapidly rising wages and positive consumer confidence.

Investment has moderated. As many large investment projects were completed in 2018, such as the construction of the Jaguar plant and some other upgrades of existing automotive capacities, investment growth decelerated from 3.7 per cent in 2018 to 1.3 per cent in the first half of 2019. While further foreign direct investment is expected this year, such as the Swiss Mubea Automotive project to construct a manufacturing plant in Presov, one of the least-developed regions in the Slovak Republic, overall investment is expected to slow, largely due to cyclical reasons. Lending to private-sector companies, especially with a maturity over five years, remains robust, but also started to lose steam in the first half of 2019.

The fiscal deficit remains historically low. The strong GDP upswing in 2018 resulted in higher tax revenues, which enabled an increase in current transfers and subsidies and higher public-sector wages. The general government deficit saw a slight deterioration to 1.1 per cent of GDP in 2018. In 2019, it is expected to improve to 0.9 per cent of GDP, before it increases somewhat in 2020, partially driven by the upcoming elections. Public debt dropped below 49.0 per cent of GDP in 2018, and will likely decrease further in the short term.

External uncertainties are the main risks to further economic growth. GDP growth will likely continue to be driven by domestic demand, although its strength will moderate. We expect growth to slow to 2.5 per cent in both 2019 and 2020. Key negative risks include the possibility of a hard Brexit and the eurozone's economic slowdown. By contrast, improved absorption of EU funds provides upside potential to that scenario.

Assessment of transition qualities (1-10)



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Major structural reform developments

A new retirement age cap is a setback to pension sustainability. In March 2019, the parliament amended the constitution by introducing a retirement age ceiling of 64 years, effective from July 2019. Previously, the formula for pension calculations tied the retirement age to average life expectancy, which is revised annually. The amended law allows women to retire earlier if they raise children and up to a year and a half early in the case of three children or more. Amid a rapidly ageing population and a rising life expectancy, embedding the retirement age cap in the constitution will adversely affect public finances and threaten the sustainability of the future pension system. According to the fiscal responsibility council, the measure will reduce future pensions by 10 per cent and will lead to a level of GDP 9 per cent lower than in a status quo scenario by 2067.

Improvements in the fight against corruption have entered into force. In February 2019, the President signed a law on the protection of whistleblowers that sees the formation of an independent state administration body with nationwide power. Effective from March 2019, the law provides protection and remuneration to whistleblowers, monitors adherence to the new anti-corruption law and educates the public about the fight against corruption. The amended law makes the protection of whistleblowers more flexible and faster than before. Until now, only whistleblowers who brought information that significantly contributed to clarifying a deed were eligible for protection. In 2018, the Slovak Republic was ranked 57th in the perception of corruption index by Transparency International, three spots lower than in the previous year.

Legislation to enhance the business environment has been proposed. In February 2019, the government approved a package of 36 measures to reduce the administrative burden on businesses and to promote digitalisation. The majority of measures are expected to be implemented by the end of 2019 and the rest in 2020. This package follows two other anti-bureaucratic packages, approved in June 2017 and May 2018, respectively. All three are expected to provide businesses savings of more than €100 million annually. In the World Bank's *Doing Business 2020* report, the Slovak Republic dropped three places to 45th out of 190 countries. The most significant deterioration was registered under the resolving insolvency sub-category. In contrast, the score for starting a business improved significantly, largely due to the abolition of the requirement to obtain and submit information on tax arrears.

Measures to simplify the recruitment process for foreigners aim to mitigate the impact of labour shortages. An amendment to the Act on Employment Services came into force in January 2019. It is intended to shorten the time for assessing non-EU nationals' requests for residence and employment in the Slovak Republic, particularly in professions with identified labour shortages. For instance, the process linked to employing foreigners has decreased in length from around 150 to 90 days. According to the country's employers' union, the Slovak economy currently needs approximately 100,000 extra workers. The Slovak Ministry of Labour estimates that the economy will need more than 500,000 new workers by 2023, mainly in industry, commerce, education, healthcare, transport and construction. As of the end of June 2019, there were more than 73,000 foreign workers in the Slovak Republic.

EU funds absorption has remained problematic. According to the prime minister's office, the Slovak Republic placed 23rd in the EU and last among the Visegrad-4 countries in terms of the share of payments received at the end of 2018 from the country's 2014-20 EU funds allocation. The government expected that the absorption of EU funds would exceed €5 billion by the end of 2019, which would represent 33 per cent of the total allocation of €15.3 billion. According to the European Commission, the lack of capacity, the absence of strategic planning as well as administrative problems are the key obstacles preventing the smooth absorption of EU funds. Consequently, the Slovak Republic has already lost €120 million in funding, partially driven by the scandals at the education ministry in 2017.

A law on the impact of Brexit is expected to lessen the potential negative impact. In March 2019, the government passed legislation amending several acts in preparation for a potential hard Brexit by the United Kingdom (UK). These measures would be effective only if the UK leaves the EU without a deal. A potential no-deal Brexit outcome is expected to have an impact not only on direct trade between the Slovak Republic and the UK, but also on indirect exports through value chain integration within the EU. According to EBRD estimates, indirect exports account for 30 per cent of overall domestic value added exports to the UK.